(14)

SUPREME COURT
OF THE UNITED STATES

OCTOBER TERM, 1943

No. 419

AUGUSTUS E. STALEY, JR., Executor of the Last Will and Testament of Augustus E. Staley, Sr., deceased,
Petitioner and Appellant below,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee below.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

CHARLES C. LeFORGEE,
Counsel for Petitioner
Decatur, Illinois

INDEX

Authorities Referred to in Petition

1. TABLE OF CASES.

C

H

INDEX (*Continued*)

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To the Honorable Harlan Fisk Stone, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

I

SUMMARY STATEMENT OF MATTER INVOLVED

This proceeding involves a deficiency tax of $79,300.00 in the Income Tax liability of Augustus E. Staley, Sr. (now deceased) for the calendar year of 1935. The deficiency

tax was upheld by a divided court in the Circuit Court of Appeals for the Fifth Circuit. (Transcript of Record, pages 163-167). Copy of opinion of said Circuit Court of Appeals attached hereto as Appendix 1.

The transaction out of which the deficiency tax was fixed was admittedly in good faith without claim that any of the interested parties contemplated any attempt to evade or defeat the provisions of any Revenue Acts of the United States.

In 1927 Mr. A. E. Staley, Sr., announced that he would transfer to each of his five children certain shares of stock in the A. E. Staley Manufacturing Company. (Transcript of Record p. 118). For various reasons the transfers were delayed until 1934. The stock originally intended to be transferred as a gift was 5,000 shares of common stock and 1,000 or 2,000 shares of preferred stock in the above mentioned corporation. In 1934 Mr. Staley, Sr., lacked approximately $150,000.00 to pay the gift tax on said contemplated gifts as estimated by auditors and tax advisers. He negotiated with bankers and brokers to sell 5,000 shares of stock to cover the deficit for the payment of the gift tax. The negotiations developed prices which he regarded as entailing a large financial loss which he declined to accept. Desiring to consumate the stock transfers Mr. Staley proposed to the trustees and beneficiaries that the transfer be for 6,000 (instead of 5,000) shares of common stock for the benefit of each of the beneficiaries and 2,000 shares of preferred stock for a consideration of $30,000.00 as to each of the trusts or a total of $150,000.00. This consideration was to be paid to Mr. Staley, Sr., by the Trustee out of trust income from any future dividends which might be declared upon all of the stock so severally transferred in trust. The beneficiaries did not have the funds with which to pay

the $30,000.00 consideration for each trust. (Transcript of Record, p. 121).

All of the children (beneficiaries) had attained their legal majority, they were residing separate and apart from their parents and there was no liability upon the part of Mr. Staley, Sr., to support the beneficiaries or in any manner pay or contribute any sums of money or property to either of them. (Transcript of Record, p. 117-118).

In October, 1934, Mr. Staley, with the assistance of his counsel, his son, Augustus E. Staley, Jr., and the representatives of the Safe Deposit and Trust Company of Baltimore, Maryland (the proposed Trustee) prepared, executed and delivered the trust instruments, and he concurrently transferred to the Trustee for each of his five children the above specified shares of stock. (Transcript of Record, p. 121).

There were five separate instruments, identical in form except as to the name of beneficiary. The trust instruments named the Safe Deposit and Trust Company of Baltimore, Maryland, Trustee, and Augustus E. Staley, Jr., as Co-Trustee. The trust instruments, so far as now material, contained the following provisions:

> "This trust agreement made this 18th day of October, 1934, by and between Augustus E. Staley, hereinafter called Donor, party of the first part, and the Safe Deposit and Trust Company of Baltimore, (a Maryland corporation), hereinafter called Trustee, and Augustus E. Staley, Jr., of Decatur, Illinois, hereinafter called Co-Trustee, the parties of the second part.
>
> "WITNESSETH:
>
> That, whereas, the Donor has assigned, transferred and delivered to the Trustee the property described in the schedule hereto attached and made a part hereof and entitled 'Schedule of the Property

of the Augustus E. Staley trust,' (hereinafter called trust estate), in trust, however, for the uses and purposes in this instrument set forth and stated.

"NOW, THEREFORE, *for and in consideration* of the sum of Thirty Thousand Dollars ($30,000.00) to be paid to the Donor, as provided in ARTICLE THIRD, and certain other good and valuable consideration paid by the parties hereto each to the other, receipt of which is by them now severally acknowledged, and in further consideration of the covenants in this instrument to be by said parties respectively kept and performed, it is hereby agreed:" (Transcript of Record, p. 11).

ARTICLE THIRD of each of said trust instruments provided for the payment of the expenses of the trust and the trustees' commissions and thereafter provided the method of paying the $30,000.00 consideration to Mr. Staley, Sr., as follows:

"(c) After the Trustee has made the payments in (a) and (b) of this ARTICLE THIRD hereof mentioned the Trustee shall out of the income by it received up to and including March 15, 1935, pay to the Donor the entire income by it received out of said trust estate, *in satisfaction of the consideration of Thirty Thousand Dollars ($30,000.00)* as hereinbefore provided, but in no event shall such payment to the Donor exceed the sum of Thirty Thousand Dollars ($30,000.00).

"After March 15, 1935, the said Trustee shall distribute the income from the said trust estate in the following manner:

"(1) After the payment of (a) and (b) (expenses and Trustee's Commissions) aforesaid it shall pay to (named child of Mr. Staley, Sr.) out of the income of said trust estate the sum of Five Thousand

Dollars ($5,000.00) per annum accounting from March 15th, 1935, all payments of said $5,000.00 shall be paid in such installments as the Trustee shall deem practicable and all sums annually received as income by said Trustee in excess of said annual payments of $5,000.00 per annum shall be by said Trustee annually paid to the Donor until the total sum of said Thirty Thousand Dollars ($30,000.00) has been paid to the said Donor." (All italics in above quotation are not so emphasized in the originals). (Transcript of Record, **pages 13-14).**

Provisions in said trust instruments further provided for the creation of a fund out of subsequent income to insure to each of said children an annuity of $5,000.00 a year after the payment of the named consideration to Mr. Staley.

The trusts were irrevocable and the stock passed out of Mr. Staley's hands by transfer to the Trustee and he was thereafter without control of the same. The trusts extended for a period not longer than 20 years after the death of a deceased child. (Transcript of Record, p. 11-21).

Dividends were declared by the Company in January and February, in 1935, which dividends upon the stock so transferred by Mr. Staley, Sr., was paid to the Safe Deposit and Trust Company of Baltimore, Trustee. The trustee, out of trust income, paid to Mr. Staley, Sr., the $30,000.00 "consideration" named in each of the instruments or a total of $150,000.00. (Transcript of Record, p. 58).

The Safe Deposit and Trust Company, as Trustee, filed fiduciary returns of income for 1935 disclosing in each instance a retained income of $39,158.54 and a tax liability of $4,674.45 and said taxes were tendered to the Collector in Baltimore, Maryland. (Transcript of Record, p. 144.)

In March, 1935, Mr. Staley, Sr., filed his income tax

return for 1934 but did not report the sum of $150,000.00 as income. (Exhibit "C"—Transcript of Record, p. 100-101).

In March, 1935, Mr. Staley, Sr., filed a gift tax return for the year 1934, then paying to the Collector of Internal Revenue a gift tax of $235,828.75. (Exhibit "E"—Transcript of Record, p. 106-107).

Upon a decision and finding adverse to Mr. Staley, Sr., before the Board of Tax Appeals the case was taken to the United State Circuit Court of Appeals in the Fifth Circuit where, by a divided court, the decision of the Board of Tax Appeals was sustained. The majority opinion as well as the dissenting opinion are filed herein. (Transcript of Record, pages 163-167). (See also Appendix 1.)

II

JURISDICTION

1. This cause involves a substantial controversy and presents a justiciable issue.

2. This is a petition for a writ of certiorari to review the finding, decision and order of affirmance by the United States Circuit Court of Appeals in the Fifth Circuit and in conformity with the Federal Statutes.

3. The Circuit Court of Appeals has exclusive jurisdiction to review decisions of the Board of Tax Appeals and its judgment shall be final except that it shall be subject to review by the Supreme Court of the United States upon certiorari.

26 U. S. C. A. Chap. 5, Sec. 1141.

4. Certiorari is the only method allowed by statute to have a review of a decision of the Circuit Court of Appeals involving any question except repugnancy of a state statute.

28 U. S. C. A., Chap. 9, Sec. 347.
Public Service Commission of Indiana v. Batesville Telephone Company, 284 U. S. 6.

The judgment of the Circuit Court of Appeals was entered June 15, 1943. (Transcript of Record, page 168).

An order was entered on June 30, 1943, extending the time for filing a petition for rehearing until July 16, 1943. (Record Page 169).

A petition for rehearing before the United States Circuit Court of Appeals for the Fifth Circuit was filed on July 8, 1943. (Record Page 170).

An order denying the petition for rehearing was entered July 17, 1943. (Record Page 174).

This petition for certiorari is presented within the time fixed by the rules of this court.

28 U. S. C. A., Chap. 9, Sec. 350.

National Labor Relations Board v. Mackay Radio and Telegraph Co., 304 U. S. 333.

III

QUESTIONS PRESENTED FOR THE CONSIDERATION OF THIS PETITION

A. RELATING TO THE PROPRIETY OF GRANTING A WRIT OF CERTIORARI.

1. Has the Circuit Court of Appeals for the Fifth Circuit rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter?

2. Has the Circuit Court of Appeals for the Fifth Circuit decided an important question of Federal Law which has not been, but should be, settled by the Supreme Court of the United States?

3. Has the Circuit Court of Appeals for the Fifth Circuit decided a Federal question in a way probably in conflict with applicable decisions of the Supreme Court of the United States?

4. Has the Circuit Court of Appeals for the Fifth Circuit so far departed from the accepted and usual course of Federal judicial decisions as to call for the exercise of the Supreme Court of the United States of its power of supervision?

5. Was the decision herein by the Circuit Court of Appeals in the Fifth Circuit the fixation of a tax by Court construction in excess of specific provisions of the Revenue Act of 1934?

6. May the courts, by construction, retroactively extend the provisions of a clear, well defined legislative act fixing the power of taxation?

B. RELATING TO THE MERITS.

1. Was the sum of $150,000.00 (being a total of the $30,000.00 payments made in each of the five trusts) "*income*" under the provisions of the Revenue Act of 1934?

2. Was the $150,000.00 paid to Mr. Staley, Sr., in 1935 a return and restoration to him of invested capital?

3. Do the five written trust instruments stating a consideration of $30,000.00 each create a contractual debt or obligation which the Trustee was bound to pay and discharge?

REASONS RELIED ON FOR ALLOWANCE OF THIS PETITION

A. CERTIORARI SHOULD BE GRANTED.

1. The Circuit Court of Appeals for the Fifth Circuit in the case at bar has rendered a decision in conflict with the decisions of other Circuit Courts of Appeal on the same matter; i. e., the Circuit Court of Appeals for the Eighth Circuit in *Curran v. Commissioner of Internal Revenue,* 49 Fed. (2d) 129, and the Circuit Court of Appeals for the Second Circuit in *Robert Hoe Estate Co., Inc., v. Commissioner of Internal Revenue,* 85 Fed. (2d) 4. (See Point 1 Brief).

2. The Circuit Court of Appeals for the Fifth Circuit has decided an important question of Federal Law which has not been, but should be, settled by the Supreme Court of the United States.

3. The Circuit Court of Appeals for the Fifth Circuit has decided a Federal question in a way probably in conflict with applicable decision of the Supreme Court of the United States in *Helvering v. Falk,* 291 U. S. 183. (See Point 2 Brief).

4. The Circuit Court of Appeals for the Fifth Circuit has so far departed from the accepted and usual course of Federal judicial decisions as to call for the exercise by the Supreme Court of the United States its power of supervision.

5. The importance of the queston involved in the administration of the Revenue laws of the United States.

6. The Circuit Court of Appeals for the Fifth Circuit,

has by construction, retroactively extended the provisions of a clear well defined legislative act fixing the power of taxation in conflict with and condemned by the decision of the Supreme Court of the United States in *Helvering v. Griffiths,* 317 U. S. . . . . . . ; 87 L. ed. 597; 63 S. Ct. 636. (See Point 3 Brief).

B. THE CAUSE SHOULD BE REVERSED ON THE MERITS.

1. Income as defined in Section 22(a) of the Revenue Act of 1934 cannot be extended to cover the consideration for the Trusts involved. (See Point 4 Brief).

2. The transaction here involved does not apply to "income" as defined in Section 161 of the Revenue Act of 1934. The sum by the taxpayer received was not "income" accumulated in trust for the benefit of unborn or unascertained person or persons with contingent interests, nor

(a) was it *"income"* accumulated or held for future distribution under the terms of the trust, nor

(b) was it *"income"* to be distributed currently by the fiduciary to the beneficiaries, nor

(c) was it *"income"* received by the estate of a deceased person during a period of administration, nor,

(d) was it *"income"* to be distributed in the discretion of the fiduciary.

The rule is mandatory that the tax shall be computed upon the net income of the trust *"and shall be paid by the fiduciary"* except as provided in Sections 166 and 167.

3. Section 166 of said Act has no place here for it

relates to revocable trusts. The Staley Trust is irrevocable.

4. Section 167 of the Revenue Act of 1934 has no application in the submitted case for no part of the income of the trusts was:

(a). in the discretion of the grantor or of any persons not having a substantial adverse interest held or accumulated for distribution to the grantor; or

(b). in the discretion of the grantor or of any person not having a substantial adverse interest to be distributed to the grantor; or

(c). in the discretion of the grantor or of any person not having a substantial adverse interest to be applied to the payment of premiums upon policies of insurance on the life of the grantor.

The sum contracted and agreed to be and which subsequently was paid to Mr. Staley, Sr., was not to be paid to him in the "discretion" of anyone. It was a fixed, definite and certain sum to meet and discharge an obligation and debt fixed in and created by and at the time of execution of the trust instruments. It was an obligation and debt which the Trustee became and was bound to discharge. Had the taxpayer sold 1,000 shares of stock to third parties and from funds so received paid the gift tax, the question of income would never have arisen. (See point 5 Brief).

5. The transfer by the grantor to the Trustee was for a valuable named consideration and the payment of this consideration by the Trustees to the grantor was not income to the grantor, Mr. Staley, Sr.

6. The $150,000.00 consideration paid to the grantor, Mr. Staley, Sr., by the Trustee was a return and restoration of capital. (See point 6 Brief).

7. The $150,000.00 received by Mr. Staley, Sr., in 1935 was a named consideration for the consummation of a certain transaction. When a consideration is so named in the instrument, the words must have the sense in which the parties understood them. (See point 7 Brief).

8. The trust instruments were contracts and it is the duty of the courts to enforce them and the intention of the parties when it is ascertained and such intention will be enforced by the courts however inartificially expressed. (See point 8 Brief).

9. The contracts expressly named a "consideration". It was the moving cause for the transactions. If it was the moving cause (and admittedly there was no gain or profit to the taxpayer) it could not, under the Revenue Act of 1934 or the decisions of the Federal Courts be regarded or held to be income for which the taxpayer should make a return.

10. The taxpayer had the right to exact and provide for the payment of a consideration to be to him paid for the creation of the trusts and agreement by the Trustee and beneficiaries to so pay the same constituted a lawful contract and in the absence of a gain or profit to the taxpayer the receipt of the consideration cannot be held to be income. (See point 9 Brief).

11. The intent of the parties is expressed and must be enforced although inartificially expressed.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a transcript of the record and proceedings herein; and that the decree of the Circuit Court of Appeals for the Fifth Circuit be reversed by this Honorable Court, and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

CHARLES C. LeFORGEE,
Counsel for Petitioner.

APPENDIX I.

IN THE

United States Circuit Court of Appeals

FOR THE FIFTH CIRCUIT

No. 10606

A. E. STALEY, JR. EXECUTOR OF THE ESTATE OF A. E. STALEY, SR., DECEASED,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of Decision of the United States Board of Tax Appeals (District of Florida).

(June 15, 1943.)

Before HUTCHESON, HOLMES, and WALLER, Circuit Judges.

HOLMES, Circuit Judge: This petition brings for review a decision of the Board of Tax Appeals sustaining a deficiency assessment made with respect to the 1935 fiduciary income tax return of the executor of the A. E. Staley estate. The questioon for decision is whether the sum of $150,000, which was paid to Staley during the tax

year from the income of certain trust estates created by him, was income or was a return of capital.

In 1934 Staley, who was chairman of the board of the A. E. Staley Manufacturing Company and owned over 80% of its common stock, created a trust for each of his five children and conveyed to each trust 6000 shares of common stock and 2000 shares of preferred stock of the corporation. It was Staley's intention to make an outright gift of the securities, but he discovered that the sum of the gift taxes to be incurred in connection with the gifts would exceed by approximately $150,000 the amount of cash he would have to pay such taxes. After considering several means by which he could secure this additional sum, he decided upon a plan to have each of the five trusts pay over to him, out of the trust income earned prior to the next succeeding tax-payment date, all of such income remaining after paying the operating expenses and trustee's fees, but such payment not to exceed $30,000. In the event that the income of the respective trusts should be inadequate to pay the full $30,000 prior to March 15, 1935, it was provided that such deficiencies should be made up out of the trust income earned thereafter.

This purpose was accomplished by inserting in each trust instrument a provision reciting that the use benefits under the trust were conveyed in consideration of the sum of $30,000, to be paid to the donor as mentioned. It is petitioner's contention that, by reason of this provision, the conveyances were not gifts but were sales of the securities for a purchase price of $150,000.

It is significant that in the trust instrument Staley referred to himself as the donor, and that, as found by the Board, he knew at the time the trusts were created that sufficient dividends would be declared upon the stock

within the five months intervening before the succeeding March 15th to cover the $30,000 payments to him for each trust. The trusts were created on October 18, 1934, and the entire $150,000 in fact was paid over to the donor by March 4, 1935. Moreover, Staley filed a gift-tax return in connection with the transaction, paying a tax computed upon the full value of the securities transferred less the value of the withheld right to receive $150,000 of the income.

It is elementary that artificial language in an instrument of conveyance does not suffice to alter the tax significance of the substance of the transaction.[1] The realities of this arrangement are not difficult to ascertain. This was no sale for an inadequate consideration; it was intended to be, and actually was, a gift of the entire corpus and of all the income except an amount necessary to assist in paying the gift taxes.[2] Expressed differently, it was an outright transfer for no consideration, but with a reservation to the donor of a portion of the income. It is immaterial for present purposes whether the transactions are regarded as gifts of all the corpus and all the income in excess of $150,000, or whether they are deemed to be gifts in trust with a reservation to the donor of a specified portion of the income. The substance is the same, and in either event the entire $150,000 was income taxable to the donor.[3] The Board of Tax Appeals reached this result, and its decision is

AFFIRMED.

[1] Lucas v. Earl, 281 U. S. 111; Minnesota Tea Co. v. Helvering, 302 U. S. 609; Griffiths v. Commissioner, 308 U. S. 343; Helvering v. Clifford, 309 U. S. 331; Helvering v. Horst, 311 U. S. 112.

[2] Cf. Griffiths v. Commissioner, 308 U. S. 343.

[3] Bettendorf v. Commissioner, 49 F. (2) 173; White v. Rose, 73 F. (2) 236; Fay v. Commissioner, 34 B. T. A. 662; Sec. 22 (a), Revenue Act of 1934; Sec. 160 (e), Revenue Act of 1934. Cf. Harrison v. Schaffner, 312 U. S. 579.

WALLER, Circuit Judge, dissenting:

It seems to me that a father could make a partial sale and gift to his child with the understanding that the sale price could be paid out of the revenue from the property given and sold without it being said that he "retained the income" from the property, when the record shows that he did not retain it but conveyed it to the trustee who was required to collect the income and pay a portion as consideration for the sale and gift. For instance, a man might own real estate of the value of $10,000.00, against which there was an indebtedness of $1,000.00, which real estate he desired his son to have. I see no reason why he could not lawfully say to his son: "I will convey this property to you provided you pay the $1,000.00 indebtedness out of the first rents you receive from the property." The fact that the seller-donor of the property knew that the property was rented and would produce income sufficient to pay the indebtedness would not make him liable for the income therefrom merely because a debt was to be paid out of it, especially when the income is devoted to the use and benefit of the *cestui que* trust in paying an indebtedness against his property.

In the case here under consideration the right to collect the income from the stock was not retained in the seller-donor but it was to be collected by the trustee and used to pay the $30,000.00 which was a part of the consideration for the gift and sale. The $30,000.00 which the trustee collected from the income of the trust estate was used for the purpose of clearing the indebtedness against the property of the *cestui que* trust, and since the income was applied to the benefit of the *cestui que* trust he should be charged with a tax thereon, and the seller-settlor should

only be charged with the sum of $30,000.00 received in the disposition of a capital asset.

Entertaining these views, I respectfully dissent from the holding of the majority.

A True copy:
Teste:

OAKLEY F. DODD
Clerk of the United States Circuit Court of
Appeals for the Fifth Circuit

(15)

SUPREME COURT
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No. 419

AUGUSTUS E. STALEY, JR., Executor of the Last Will and Testament of Augustus E. Staley, Sr., deceased,
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BRIEF OF PETITIONER, AUGUSTUS E. STALEY, JR., EXECUTOR OF THE LAST WILL AND TESTAMENT OF AUGUSTUS E. STALEY, SR., (deceased) IN SUPPORT OF HIS PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

CHARLES C. LEFORGEE,
Counsel for Petitioner.
Decatur, Illinois.

INDEX TO BRIEF

SUBJECTS

AUTHORITIES REFERRED TO

1. *Table of Cases*

A.

II.

PAGE

2. *Textbooks*

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A. THE WRIT OF CERTIORARI SHOULD BE GRANTED

Point 1. The Circuit Court of Appeals for the Fifth Circuit has rendered a decision in Conflict with Decisions of other Circuit Courts of Appeal on the same matter.

In the case at bar the Circuit Court of Appeals for the Fifth Circuit, by a divided court, has held that the payment of a named consideration by the Trustee to the grantor was income to the grantor. This consideration was exacted by the grantor in return for the conveyance of the trust res and under the terms of the trust instrument was to be paid by the trustee out of trust income arising from any future dividends which might be declared upon stocks held as trust res.

(a) *Curran v. Commissioner of Internal Revenue*, 49 Fed. (2d) 129, was decided by the Circuit Court of Appeals for the Eighth Circuit. In that case a deficiency assessment resulted from a payment, by way of credit on indebtedness, which came to the petitioner in that case through the form of a dividend declared by the Con P. Curran Printing Company. The position of the Commissioner was that the payment to the petitioner was a dividend from the above corporation, while the petitioner contended that it came as his portion of the payment of the consideration for a valuable building conveyed by him to the corporation. The court held that though the payment was in the form of a corporate dividend, it was in fact payment for a building, therefore, *a restoration of capital*, and not "taxable as income to the petitioner." In its opinion the court stated:

"The Board found there was a sale. It finds that 'it was finally agreed that the corporation would pay and he would take $150,000.00 for the property. The petitioner then executed and delivered the deed to the property which was recorded October 13, 1920. No payment was made to the petitioner on account of the transfer of the property in 1920.' The findings following the quotation just made leave no doubt of the view of the Board that this 'dividend' for $150,000.00 declared January 15, 1921, was really a payment of this purchase price. In this connection there is a significant statement in the opinion of the Board on the finding as follows: 'We are convinced from all the evidence that the petitioner intended that the corporation should pay $150,000.00 for the property. We also believe that the petitioner was satisfied with the action as taken by the corporation in declaring and paying the dividend.' We think the findings must be construed as being that the property was sold to the corporation, and that payment therefor was through the medium of this 'dividend.' *Further, it may be said that, once given the finding that this transaction was a sale, there is no support in the evidence for any view as to the dividend, except that it was in payment therefor.*

"Upon such findings, the Board could not properly affirm the action of the Commissioner that this payment to petitioner was taxable as a dividend. *The payment was, except in bare form, no dividend, but it was really a payment for property purchased at what the evidence shows was less than its real value.*" (Italics ours.)

Likewise, in the case at bar, Augustus E. Staley, Sr., was not a beneficiary under the trusts. There was a transfer by him of the trust res to the Trustee for the benefit of the cestui que trust. The trust instruments merely named Mr. Staley, Sr., the grantor, as the person who was to be paid the consideration fixed by the terms of an instrument providing for transfers of stock which constituted the

corpus of the trust estates. It clearly appears that the trusts would not be created except upon the express agreement and contract between the grantor, Mr. Staley, Sr., and the Trustee that said grantor would receive a consideration of $150,000.00 for making the transfers. The consideration, as in *Curran v. Commissioner, supra,* was exacted by Mr. Staley, Sr., for the grant of certain res which he had not originally intended to convey. It was agreed that the Trustee would pay to Mr. Staley the above consideration for the stock transfer which was a greater number of shares than he originally intended to convey. The grantor then executed the trust instruments and transferred and delivered the stocks. It is evident that all interested parties intended that the Trustee should pay $30,000.00 for the stocks transferred in this transaction.

Clearly, the decision in the case at bar is in conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit in *Curran v. Commissioner of Internal Revenue,* 49 Fed. (2d) 129.

(b) *Robert Hoe Estate Co., Inc., v. Commissioner of Internal Revenue,* 85 Fed. (2d) 4, was decided by the Circuit Court of Appeals for the Second Circuit. In that case it appeared that devisees of realty under a will which failed to provide for widow's dower formed a corporation to manage the realty and agreed with the widow that, in consideration of her conveyance and release of dower, the corporation would pay her annually an amount equal to one-third of the net annual income, or, on sale of any part of the realty, the corporation would pay her a gross sum in lieu of dower to be estimated according to the then value of an annuity. The corporation taxpayer's theory was that such agreement diverted one-third of the profits as they were received from the land directly to the

widow, and that she retained an interest in the land, whose profits, therefore, became her income as they accrued. The court, however, ruled that the income was that of the corporation taxpayer, and *represented a return of capital to the widow, not income.* In its opinion the court, at page 4, said:

> "Perhaps an agreement between the devisees and the widow, which preceded that of the company, may have been in effect an admeasurement of her dower, as the taxpayer argues, but, if so, it is irrelevant, unless from this it followed that she retained some interest in the lands. That she certainly did not do; the promise was not to pay her one-third of the profits in kind, to say nothing of giving her any right in the land itself; it was general and created a general obligation; had the company lost the money, even after the utmost diligence to keep it, it would still have been liable; payment and payment alone would be a discharge. The profits therefore belong to the taxpayer, though they measure its performance to the last cent; for good or ill the parties meant the widow to part with all interest in the land and its usufruct; she was to be content with the promise alone."

In the case at bar, Mr. Staley, Sr., the grantor, parted with all interest in the stock which he transferred to the Trustee. As in *Robert Hoe Estate Co., Inc., v. Commissioner, supra,* he "was to be content with the promise alone" to be paid the named consideration out of net income from the trust res. Mr. Staley, Sr., certainly *did not retain* any interests in the stocks which became trust res. Mr. Staley, Sr., the grantor, by no stretch can be treated as the beneficiary of the trust; he was only the grantor and the person who was to be paid the consideration named in the trust instruments. The written agreement between the grantor, Mr. Staley, Sr., and the Trustee fixing the consideration for the transfer was a contract and as in

Robert Hoe Estate Co., Inc., v. Commissioner, supra, created an obligation on the Trustee to pay the consideration fixed, agreed upon and contracted for. Payment of the consideration fixed in and by the trust instruments, and payment alone would be a discharge of the obligation of the Trustee to pay the named consideration.

The decision in the case at bar clearly is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Robert Hoe Estate Co., Inc., v. Commissioner,* 85 Fed. (2d) 4.

Point 2. The Circuit Court of Appeals for the Fifth Circuit has decided a Federal question in a way probably in conflict with decisions of the Supreme Court of the United States.

The Circuit Court of Appeals in the case at bar, by a divided court, held that a grant to a child with the understanding that the price could be paid out of the revenue from the property given and transferred was retained income to the grantor, Mr. Staley, Sr. This transaction for a named consideration is clearly restoration of capital assets. It is not claimed by the Commissioner that there was *a capital gain* to the grantor. Clearly, the holding in the case at bar is in direct conflict with the decisions of the Supreme Court of the United States that *in a transaction involving a restoration of capital, taxable income does not result unless the transaction results in capital gain to the taxpayer.*

In *Helvering v. Falk,* 291 U. S. 183, the beneficiary of a certain trust claimed the right to deduct from the total received, as a *return of capital assets,* his proportionate share of depletion. The court held that *a return of capital assets was not taxable* as income and at pages 188-189 said:

"True it is that Sec. 219 (b) directs that in cases of 'income which is to be distributed to the beneficiaries periodically,' * . . . 'the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary.' But we cannot accept the view that this was intended to impose a tax upon that part of the proceeds which represents *the return of capital assets,* whenever this has been paid over to the beneficiary."

The consideration exacted by the grantor, Mr. Staley, Sr., for the creation of the trust clearly was a restoration of capital to the grantor. The income from the trust res was applied to the benefit of the cestui que trust by discharging the indebtedness against the trust res which had been created by the contract between the grantor-seller and the Trustee. This contract was entered into at the time and as a part of the trust instruments.

Throughout the contention of the Commissioner, in a variety of forms, runs the fundamental error—a failure to appraise correctly the force of the term "income" as used in the Revenue Act of 1934, or at least to give practical effect to it—a failure to recognize that the consideration paid to Mr. Staley, Sr., by the Trustee, was a return of capital, not income.

The dissenting opinion of Mr. Justice Waller of the Circuit Court of Appeals in the case at bar clearly recognizes and appraises correctly the force of the term "income" as used in the Revenue Act and *holds that the consideration paid to the grantor was not income.*

Point 3. The Circuit Court of Appeals for the Fifth Circuit has made a retroactive holding.

In *Helvering v. Griffiths,* 317 U. S. ...; 87 L. ed. 597; 63 S. ct. 636, the Supreme Court of the United States, speaking through Mr. Justice Jackson, pointed out the hardships which would be incident to a retroactive holding as in the case at bar, condemned such retroactive holdings and said:

> "We are asked to make a retroactive holding that for some seven years past a multitude of transactions have been taxable although there was no source of law from which the most cautious taxpayer could have learned of the liability. If he consulted the decisions of this Court, he learned that no such tax could be imposed; if he read the Delphic language of the Act in connection with existing decisions, it, too, assured him there was no intent to tax; if he followed the Congressional proceedings and debates, his understanding of nontaxability would be confirmed; if he asked the tax collector himself, he was bound by the Regulations of the Treasury to advise that no such liability existed. It would be a pity if taxpayers could not rely on this concurrent assurance from all three branches of the Government. But we are asked to brush all this aside and simply to decree that these transactions are taxable anyway."

It is evident in the case at bar, that, at the time the trust instruments were executed, the consideration contracted for and agreed to be paid to the grantor, Mr. Staley, Sr., was not considered "income" to him either under the Revenue Act or the Regulations or the decisions of the Board of Tax Appeals or of any court of record. The Commissioner now seeks to have the courts make a retroactive holding that the transaction in the case at bar was taxable "although there was no source of law from which the most cautious taxpayer could have learned of the liability" (*Helvering v. Griffiths, supra*). Clearly the court will not aid the Commissioner and will not extend the Revenue Act by

implication beyond the clear import of the language used. The Supreme Court in *U. S. V. Merriam,* 263 U. S. 189 in no uncertain terms laid down the rule from which there can be no departure where it said:

> "But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer."

B. THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT SHOULD BE REVERSED ON THE MERITS.

Point 4. The consideration was not income within the definition of the Revenue Act.

> "Gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever, . . . "

Section 22(a) of the Revenue Act of 1934.

The statute does not impose an income tax upon everything which is *received* by the taxpayer.

Shellabarger v. Commissioner of Internal Revenue, 38 Fed. (2d) 566.
Barnes v. Alexander, 232 U. S. 117.

Income has repeatedly been defined by this court as gain *derived* from capital, from labor, or from both combined, including profit gained through sale or conversion of capital.

Bowers v. Kerbaugh Empire Co., 271 U. S. 170.
Strattons Independence v. Howbert, 231 U. S. 399.
Doyle v. Mitchell Bros. Co., 247 U. S. 179.
Eisner v. Macomber, 252 U. S. 189.
Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509.
Goodrich v. Edwards, 255 U. S. 527.

In the case at bar the consideration received by Mr. Staley, Sr., clearly did not represent a gain derived from capital, labor or from both combined or any gain or profit whatsoever. A. E. Staley, Sr., merely transferred his assets, and in consideration therefor received a different sort of property, namely, money, which was of far less value than the property transferred in trust, and, therefore, since it did not result in a gain clearly was not income to Mr. Staley, Sr.

Point 5. The consideration was not income under Section 167 of Revenue Act.

"(a) Where any part of the income of a trust—

"(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

"(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

"(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called 'charitable contribution' deduction); then such part of the income of the trust shall be included in computing the net income of the grantor.

"(b) As used in this section, the term 'in the discretion of the grantor' means 'in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question'"

Section 167 of the Revenue Act of 1934.

(a) The decisions interpreting Section 167 as well as what was income under the Revenue Acts are immersed in confusion. In discussing the obscurity which exists under the Revenue Acts, not only as to Income tax, but also as to Estate and Gift taxes, Professor Paul in his recent Federal Estate and Gift Taxation, comments as follows in Vol. 1, sec. 7.32 at page 392:

"Each amendment has added to the existing statute until we now have in the Internal Revenue Code an unintelligible conglomeration of language, which is in sad need of rearrangement and simplification."

And in Vol. 1, sec. 7.28, page 383:

"The income tax decisions interpreting Section 167 furnish no useful analogy, even if the confusion in which they are immersed could be dissipated."

In Vol. 1, sec. 7.01, page 283:

"It requires the most painstaking analysis to make any headway in understanding them; even today, after many years and attempts at clarification, few would

be bold enough to say they had mastered them. Bewildered administrative authorities and puzzled courts have added words to words, but little meaning emerges from the resulting thicket of obscurity."

And at pages 283-284:

> "We have been like Englishmen who never clean their slates; no language could be thrown away if anyone thought in optimistic vein that he understood its meaning. Amendments consisted of addition, duplication and overlapping. No one suggested the heroic remedy of fresh language which would clear away the debris and say simply what was plainly dictated by disillusioning experience with a statute that had repeatedly failed to say what the Treasury, at least, thought it meant."

In Vol. 2, sec. 17.08, page 1152:

> "Hope springs eternal in the breasts of taxpayers who yearn for certainty. One of the most perennial of taxpayer attitudes looks to the Supreme Court to clear away the debris of misunderstanding which accumulates around conflicting decisions of the Board and lower courts on difficult subjects."

The Supreme Court of the United States has often commented on this confusion and obscurity. In the recent case of *Helvering v. Griffiths,* 317 U. S. . .; 87 L. ed. 597; 63 S. ct. 636, the Supreme Court in recognizing the injustice of efforts by the Commissioner to impose a tax liability by a retroactive holding said:

> "We are asked to make a retroactive holding that for some seven years past a multitude of transactions have been taxable although there was no source of law from which the most cautious taxpayer could have learned of the liability. If he consulted the decisions of this Court, he learned that no such tax could be imposed; if he read the Delphic language of the Act

in connection with existing decisions, it, too, assured him there was no intent to tax."

(b) The courts have repeatedly held that payments of a stated consideration by a grantee to a grantor, out of income from the conveyed property, *is not income to the grantor,* but is income to the grantee.

In *Curran v. Commissioner,* 49 Fed. (2d) 129, the court held that though the payment was in the form of a corporate dividend, it was in fact payment of agreed consideration for a building, therefore, a restoration of capital, *and not taxable income to the grantor.* In its opinion the court stated:

> "There is no dispute that this payment to petitioner by the corporation was in the form of a corporate dividend, although the dividend was hedged about the restrictions which are entirely unusual. The theory of a dividend is that it shall be payable only from net earnings which are or may be ready for actual distribution at a definite date provided for in the resolution declaring the dividend. But here, although the actual net earnings of the corporation at the time this dividend was declared were sufficient to pay it, there was no definite date set for payment, but, on the contrary, the amount of the dividend was to be merely credited on the corporation books, to bear interest (payable quarterly) and could not be withdrawn except on order of the management.
>
> ". . . .
>
> "The Board found there was a sale. It finds that 'it was finally agreed that the corporation would pay and he would take $150,000. for the property. The petitioner then executed and delivered the deed to the property which was recorded October 13, 1920. No payment was made to the petitioner on account of the transfer of the property in 1920.' The findings following the quotation just made leave no doubt of

the view of the Board that this 'dividend' for $150,000.00 declared January 15, 1921, was really a payment of this purchase price. In this connection there is a significant statement in the opinon of the Board on the finding as follows: 'We are convinced from all the evidence that the petitioner intended that the corporation should pay $150,000.00 for the property. We also believe that the petitioner was satised with the action as taken by the corporation in declaring and paying the dividend.' We think the findings must be construed as being that the property was sold to the corporation, and that payment therefor was through the medium of this 'dividend'. *Further, it may be said that, once given the finding that this transaction was a sale, there is no support in the evidence for any view as to the dividend, except that it was in payment therefor.*

"Upon such findings, the Board could not properly affirm the action of the Commissioner that this payment to petitioner was taxable as a dividend. *The payment was, except in bare form, no dividend, but it was really a payment for property purchased at what the evidence shows was less than its real value.*" (emphasis ours.)

Likewise, in the instant case, Mr. Staley, Sr., was not a beneficiary under the Trusts. He was named as a creditor who was to be paid a consideration for the transfers of the stock which constituted the corpus of the trust estate. The consideration became and was a charge against the corpus of the trust estate at the time of the execution of the trust instruments.

Scott, Law of Trusts, vol. 1, sec. 10.3, page 71.

The rule that the mere fact that one receives a dividend or a payment does not make such dividend or payment taxable as income to the party receiving the same is clearly set forth in *Shellabarger v. Commissioner,* 38 Fed. (2d) 566, as follows:

"The mere fact of Maud's receiving it does not indicate that it was taxable income. The statute (Act June 2, 1924, Chap. 234, sec. 213 (a), 43 Stat. 267) does not impose an income tax upon everything which is received by the taxpayer. Many items may be received which are not taxable income of the respondent. 'Derive'—not 'receive'—is the word the statute employes."

(c) The obligation to pay the consideration was a debt of the trustees to the grantor.

"Where the owner of property transfers it in trust, it is of course a valid trust although he received no consideration for creating it. Indeed, in most cases where property is transferred in trust, the transaction is gratuitous."

Scott on Trusts, Vol. 1, sec. 29, page 178.

Although an executed deed or conveyance in trust requires no consideration, yet, if made for a promised consideration, the promise is enforcible and the consideration, if monetary, may be collected as a debt.

Professor Scott, in his recent work in The Law of Trusts announces the well established rule that a contract between the settlor and the trustee entered into in connection with the creation of a trust is enforcible and in Vol. 2, Sec. 197.2 at pages 1069-1070 says:

"In conection with the creation of a trust the trustee may of course enter into a contract with the settlor. He may agree to do something other than merely to perform his duties as trustee. . . . In such a case if he fails to carry out his promise an action at law for breach of contract can be maintained against him by the settlor."

The obligation under an express trust to pay a named consideration may be payable at a fixed time, or on demand

or on an installment basis. Where there is a legal obligation to pay, as in the case at bar, the terms of the trust instrument control the time and manner of payment.

Lobban v. Wierhauser, (Texas) 141 S.W. (2d) 384.

The courts of Tennessee have held that where there is an expressed consideration in the trust instrument the settlor may and has the right to bring an action for specific performance. (*Farrell v. Third National Bank in Nashville,* (Tenn.) 101 S. W. (2d) 158). In the last cited case several trust instruments were executed concurrently by brothers and sisters with a recital in each that the instrument is executed by the settlor in consideration of the settlor's brothers and sisters executing a substantially similar trust. All of the trusts were executed. Subsequently, the trust executed by one of the settlor's brothers in New York was held to be null and void. The court held that the settlor could file a bill for specific performance based on the express consideration set out in her trust instrument.

In the case at bar the trust instruments clearly were enforcible contracts between the settlor and the trustee. By each of these trust instruments the trustee became obligated and indebted to the settlor in the amount of $30,000.00, the consideration moving from the trustee to the settlor for the execution of each of these trusts. Clearly this indebtedness was not income to the settlor, A. E. Staley, Sr.

There is no power under sections 161, 162, 167 or section 22a of the Revenue Act of 1934 authorizing the deficiency tax fixed by the commissioner in this cause or bringing the moneys received by Mr. Staley, Sr., within the definition of "income".

"If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the *letter of the law*, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be." (Italics ours.)

United States v. Merriam, 263 U. S. 179.

See also:

DeGanay v. Lederer, 250 U. S. 376.

The position of the Commissioner in this case is unique and the decision of the Circuit Court of Appeals in the Fifth Circuit is in line with the claim of the Commissioner.

No attempt has been made to deny that the construction of the trust instruments as between Mr. Staley, the grantor, of the one part and the Trustee and the beneficiaries of the other part means other than that the sums named in the instrument were to be paid as a consideration for the making of the trust indentures and transfer of the stock. The construction sought by the Commissioner is that under the Federal Statutes the money paid to Mr. Staley was "income" and that while the first above mentioned construction as between Mr. Staley and the other contracting parties is correct and enforceable as between them, there is another construction under the Federal Statutes to the end that the money so paid as the consideration named in the trust instrument is "income". The statutes are perfectly clear and no law exists by which the income in this case can be made to extend to the money paid to Mr. Staley. The plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful

intellect would claim that by implication they were included in the Act.

Imperial Fire Insurance Company v. Coos County, 151 U. S. 452.
U. S. v. Deans, (CCA-8) 230 Fed. 957.
U. S. v. Ninety-Nine Diamonds, (CCA-8) 139 Fed. 961, 965.
Martha Stevens v. Nave-McCord Mercantile Co., (CCA-8) 150 Fed. 71, 75.
Standard Life & Accident Ins. Co. v. McNulty, (DC) 157 Fed. 224, 226.
Delaware Ins. Co. v. Greer, (DC) 120 Fed. 916, 921.

If the construction of the Revenue Acts claimed by the Commissioner is to prevail it must be under a statute bringing the case within the provisions of the Act. No power exists to supply an omission in the law by which the courts may extend the express words in the Act employed to produce or create a mischievous and absurd addition to the law for the purpose of collecting a tax.

Point 6. The $150,000.00 consideration received by the grantor-seller, Mr. Staley, Sr., was a restoration of capital.

Under the admitted facts in this case Mr. Staley, Sr., transferred common and preferred stocks for a consideration of $150,000.00 to be paid by the trustees under the five trusts. For such transaction he received a valid legal promise to pay to him $150,000.00 and subsequently in lieu of the promise and the stock by him transferred he received the cash which merely restored to him certain of his capital without any capital gain to him.

Eisner v. Macomber, 252 U. S. 189.
Helvering v. Falk, 291 U. S. 183.
United States v. Ludey, 274 U. S. 295.

The $150,000.00 consideration so received was a restoration of capital and was not income.

Robert Hoe Estate Co., Inc. v. Commissioner, 85 Fed (2d) 4.
Curran v. Commissioner, 49 Fed. (2d) 129.
Shellabarger v. Commissioner, 38 Fed. (2d) 566.

Point 7. **Consideration**

The Trust Indenture executed by Mr. Staley specifically recited that his undertakings (by him fully executed concurrently with the delivery of the trust instrument) was for a named "consideration" to be to him paid as in the trust instrument provided.

Professor Williston (Vol. 1, sec. 103c) in substance states that, while mutual promises are not always a sufficient consideration, the test as laid down by able writers is:

"1. Sir Frederick Pollock and Professor Langdell apply this test: If the obligation of a promise would be a detriment to the promisor (assuming that the promise creates a binding obligation) the promise is sufficient consideration.

"2. 'That most accurate of writers, Mr. Stephen Leake,' whose work on contracts has long been a standard treatise, says, however,—

" 'So far as regards the matter of the consideration, as being executed or executory, it may be observed that whatever matter, if executed, is sufficient to form a good executed consideration; if promised, is sufficient to form a good executory consideration; so that the distinction of executed and executory consideration has no bearing upon the question of the sufficiency of any particular matter to form a consideration.' "

Consideration is the moving cause of transfers.

Donahoe v. Rich, (Ind.) 28 N. E. 1001.
Blair Engineering Company v. Page Steel and Wire Company, 288 Fed. 662.
Cassinelli v. Stacy, (Ky) 38 S. W. (2d) 980.

Each of the Trust Indentures recite that it was made and the stock transferred "in consideration" of the sum of $30,000.00 to be to Mr. Staley paid in each of the five trusts in the manner therein provided. In accordance with such provisions the $30,000.00 was paid. No controversy arises under the record in this case as to the clear provisions so expressed in the instrument nor is there any evidence to dispute the express distinct provisions of the instrument.

Professor Williston (Williston on Contracts, Vol. 1, page 242) states:

> "It is at least well settled that the recital of consideration in a deed of conveyance estops the grantor to deny the existence of that consideration for the purpose of impeaching the validity of the deed, as a deed of bargain and sale." (See cases there cited).

While the original rule at common law forbidding parole evidence to explain the consideration has been relaxed, nevertheless, it is established that at the present time even though the "consideration" in fact was entirely different from the consideration named in the deed, not merely additional to it, the truth may be shown for any purpose *except the impeachment of the validity of the deed for lack of consideration unless the stated consideration is promissory in character and not merely a recital in fact.*

Williston on Contracts, Vol. 1, sec. 115a and cases there cited.

Damages to the promisee constitute as good a consideration as benefit to the promisor.

> *Townsley v. Sumrall,* 2nd Peters 170-182.
> *United States v. Linn, et al.* 15th Peters 290.
> *Cuneo Press, Inc. v. Claybourn Corp.,* 90 Fed. (2d) 233-236.

Courts will avoid a construction which will make a law operate with glaring inequality and palpable injustice.

> *Knowlton v Moore,* 178 U. S. 41.
> *Eidman v. Martinez,* 184 U. S. 578.
> *American Net and Twine Co. v. Worthington,* 141 U. S. 468.
> *Hartranft v. Wiegmann,* 121 U. S. 609.
> *United States v. Isham,* 17th Wall. 496.

Point 8. The trust instruments were contracts.

(a) A trust instrument, supported by a legal and valuable consideration, is a binding contract between the settlor and the Trustee. This universally followed rule of law is announced by Roscoe Pound in his article, Consideration in Equity, 13 Ill. Law Review, 669, where he said:

> "The creation of an express trust is analytically a legal transaction of the same order as a contract."

In *Underhill v. United States Trust Co.,* (Ky.) 13 S. W. (2d) 502, at page 505 the court said:

> "A voluntary deed of trust, as suggested by the learned chancellor in his excellent opinion, *is a binding contract* between the settlor and the trustee acting for the cestuis que trust, supported by a legal and valuable consideration. . . . Burton v. Burton's Trustee, 198 Ky. 429, 248 S. W. 1033."

And in *Lobban v. Wierhauser,* (Texas) 141 S. W. (2d) 384; at page 385, the court stated:

"An express trust is one which results from, and is based on, *a contract* which involves the separation of the legal and the equitable title, Wheeler v. Haralson, 128 Tex. 429, 99 S. W. 2d 885."

In the case of *Hutchison v. Ross,* (N. Y.) 187 N. E. 65; at pages 71-72 the court said:

"The difficulty in this case is that on the face of the contract the conveyance in trust seems to have been made, at least partly, in consideration of the revocation of the provisions of the marriage contract and according to the recitals 'in lieu of the provisions * * * contained in said contract of marriage settlement.' Though an executed deed or conveyance in trust requires no consideration (Stiebel v. Grosberg, 202 N. Y. 266, 95 N. E. 692, 36 L. R. A. (N.S.) 1147, Ann. Cas. 1912D, 1305), yet, if made for a promised consideration 'which fails, the conveyance may be revoked. . . . Upon the face of the agreement the wife's renunciation is the consideration for the husband's conveyance in trust."

Where an express trust agreement is entered into for a valuable and legal consideration, court will enforce it as a contract.

Perry on Trusts, 7th ed., Vol. 1, pages 109-110.

(b) Trust instruments are to be construed as contracts.

In construing contracts words must have the sense in which parties understood them and the court will consider the nature of the contract, the object to be attained and all the circumstances to reach the intention of the parties.

Aetna Insurance Company v. Boon, 95 U. S. 117.

Florida Central Railroad Company v. Schutte, 103 U. S. 118.

Green v. Biddle, 21 U. S. 1, 8th Wheat. 1.

Dundas v. Hitchcock, 53 U. S. 256.

The Chenango Bridge Co. v. Binghamton Bridge Co., 70 U. S. 51.

It is the province of courts to enforce contracts, not to make or modify them.

The Harriman vs. Emerick, 76 U. S. 161.

The intention of the parties is the contract and whenever it is ascertained, however inartificially expressed, it is the duty of the court to give it effect.

Bradley v. Washington, Alexandria and Georgetown Packet Co., 38 U. S. 89.
George v. Tate, 102 U. S. 564.
Ogden v. Saunders, 25 U. S. 213.
Delaware and Hudson Canal Company v. Pennsylvania Coal Company, 75 U. S. 276.

Point 9. The taxpayer had the right to exact a payment as consideration.

Mr. Staley, Sr., the grantor in the five trusts, had the right to exact payment of money or property as *consideration* for the creation of the trust.

"Effect is given to the *consideration* to carry out the intention of the parties."

Perry on Trusts, 7th ed., Vol. 1, Page 111.

A grantor had the right to exact a promise from the Trustee to perform certain acts as consideration for creation of the trusts, which promise is enforceable.

Ketcham v. Miller, (Texas) 37 S. W. (2d) 635.
Hutchison v. Ross, (N. Y.) 187 N. E. 65.

Courts do not take any peculiar position with regard to the meaning of consideration in trust instruments. "They . . . apply the same criteria as they would use in regard to any other contract."

Bogart, Trusts and Trustees, Vol. 1, Ch. 12, Sec. 204, page 579.
Roscoe Pound, Consideration in Equity, 13 Ill. Law Review 667-692.

The consideration may be a detriment either to the Trustee or the cestui.

Bogart, Trusts and Trustees, Vol. 1, Ch. 12, Sec. 204, Page 579.
Pass v. Stephens, (Ariz.) 198 P. 712.
Frazer v. Stokes, (Va.) 71 S. E. 545.

Respectfully submitted,

CHARLES C. LEFORGEE,
Counsel for Petitioner.

INDEX

CITATIONS

557692—43

In the Supreme Court of the United States

October Term, 1943

No. 419

A. E. Staley, Jr., Executor of the Estate of A. E. Staley, Sr., Deceased, petitioner

v.

Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 38–47) is reported at 47 B. T. A. 260. The opinion of the circuit court of appeals (R. 162–165) is reported at 136 F. 2d 368.

JURISDICTION

The judgment of the circuit court of appeals was entered on June 15, 1943 (R. 165–166), and the petition for rehearing denied on July 17, 1943 (R. 171). The petition for writ of certiorari

was filed October 8, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Where, in making gifts of stock in trust to his children in 1934, the father specified in the trust instruments that $150,000 out of the first income was to be paid to him, and that amount was actually distributed to the father in 1935, was such amount properly included in the father's gross income for 1935?

STATUTE INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual except that—

* * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * * but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows (R. 39–45):

A. E. Staley, Sr., referred to as the decedent, determined to make a gift of the stock of his controlled corporation in trust for the benefit of each of his five children. It was ascertained that the transfer of the proposed gifts in trust would entail a gift tax aggregating approximately $150,000 more than the amount of cash which decedent had available for payment of such tax. He thereupon decided to transfer the stock in trust in such a way as to enable him to raise the $150,000 necessary for payment of the gift tax. (R. 39.)

On October 18, 1934, decedent executed his five trust instruments and delivered to the trustee, as the corpus of each trust, certificates representing 6,000 shares of common stock and 2,000 shares of preferred stock of the corporation. At the date of these transfers, the common stock had a value of $42.50 a share and the preferred stock had a value of $85 per share. (R. 39–40.)

The five trust instruments were identical except as to the named beneficiary, and contained, among other provisions, the following (R. 40–42):

> That, Whereas, the Donor has assigned, transferred and delivered to the Trustee the property described in the schedule hereto attached * * * in Trust, however, for the uses and purposes in this instrument set forth and stated.
>
> Now, Therefore, for and in consideration of the sum of Thirty Thousand Dollars ($30,000.00) to be paid to the Donor, as provided in Article Third, and certain other good and valuable considerations paid by the parties hereto each to the other, receipt of which is by them now severally acknowledged, and in further consideration of the covenants in this instrument to be by said parties respectively kept and performed, it is hereby agreed:
>
> Article Third: Out of the income derived and received by my said Trustee from the Trust Estate, the Trustee shall:
>
> (a) Upon the written approval of the Co-Trustee, pay all taxes, costs and ex-

penses necessary for the preservation and maintenance of said Trust Estate.

(b) Out of the income of said Trust Estate to annually pay to the Trustee two percent (2%) for the services by it rendered as such Trustee, and annually pay two percent (2%) of the income of said Trust Estate to the Co-Trustee so long as said Co-Trustee shall so act as Co-Trustee.

(c) After the Trustee has made the payments in (a) and (b) of this Article Third hereof mentioned, the Trustee shall out of the income by it received up to and including March 15, 1935, pay to the Donor the entire income by it received out of said Trust Estate, in satisfaction of the consideration of Thirty Thousand Dollars ($30,000.00) as hereinbefore provided, but in no event shall such payment to the Donor exceed the sum of Thirty Thousand Dollars ($30,000.00).

After March 15, 1935, the said Trustee shall distribute the income from said Trust Estate in the following manner:

(1) After the payment of (a) and (b) aforesaid, it shall pay to * * * [the named beneficiary] out of the income of said Trust Estate the sum of Five Thousand Dollars ($5,000.00) per annum, accounting from March 15, 1935, all payments of said Five Thousand Dollars ($5,000.00) shall be paid in such installments as the Trustee shall deem practicable, and all sums annually received as income by said Trustee in excess of said annual payments of Five

> Thousand Dollars ($5,000.00) per annum, shall be by said Trustee annually paid to the Donor until the total sum of said Thirty Thousand Dollars ($30,000.00) has been paid to the said Donor.

In January 1935, the trustee received five checks of $7,000 each from the corporation in payment of a dividend on preferred stock of the corporation held in trust. After deducting its commission and certain minor expenses from these dividend checks, the trustee sent its check to decedent in the sum of $33,600 in partial satisfaction of the aggregate of $150,000 to be paid under the trust instruments. (R. 44.)

In February 1935, the corporation declared a dividend on common stock and the trustee received an aggregate of $150,000 in dividends on this stock held in the five trusts. From this dividend payment, the trustee paid decedent the balance of the sum payable under the provisions of the five trusts. (R. 44.)

On or about March 15, 1936, the trustee filed a fiduciary return of income for 1935 in behalf of each of the trusts, reporting therein retained income taxable to the trusts, which included the amounts paid to decedent under the provisions of article third of the trust instruments (R. 44).

Decedent did not report as gross income the $150,000 received by him in 1935 from the trustee and paid in accordance with the trust instruments (R. 44).

On March 16, 1935, decedent filed a gift tax return for the year 1934 and reported therein the five gifts in trust made in 1934 for the benefit of his children. He excluded from the reported value of the gifts in trust the $150,000 payable to him under article third of each of the trusts. (R. 44.) The Commissioner determined a deficiency in gift tax liability which the decedent petitioned the Board to redetermine but in doing so the Board held that the sum of $150,000, representing the aggregate amount of payments under article Third of the trust instruments was properly excluded in computing the value of gifts made by the decedent (R. 45).

The Board held that the $150,000 paid to the decedent out of the income of the five trusts was taxable to him (R. 47) and found a deficiency due of $79,300.99 for 1935 (R. 48).

The circuit court of appeals affirmed the Board's decision. (R. 162–166.)

ARGUMENT

1. The court below correctly held that the $150,000 was income taxable to the decedent. It is clear that such amount was paid to the decedent as income to which he was entitled and not as a return of capital. As both the Board of Tax Appeals and the court held, this is not a case of sale but of one involving gifts in trust with a

reservation of income by the grantor for himself to the extent of $150,000.[1]

As substance not form governs in tax cases, technical niceties should not control in interpreting the trust instruments here. Thus while such instruments refer (R. 40–42) to the "consideration" payable to the decedent, it is obvious that he did not sell $2,000,000 worth of stock to his children for the inadequate consideration of $150,000, nor did he make sales in part and gifts in part. The evidence shows that the decedent wished to make gifts of stock to his children but knew that the resulting gift tax would require more cash than he had and, being elderly, did not wish to delay the gifts until dividends, which would be declared in about six months, could be collected. It was suggested that he sell some of the stock either on the open market or to his children but he rejected both plans because the market price was too low and his children did not have the money needed. (R. 120–121, 129.) Accordingly, the decedent met his difficulty by creating a trust and providing in the trust instruments that he should receive income to the extent of

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[1] The Board and the court both agreed that the decedent would be taxable under Section 22 of the Revenue Act of 1934, *supra*, but the Board also indicated, as an alternative reason for its holding, that he could be taxed as a preferred beneficiary under Section 162, *supra*. We agree with the Board that both sections are applicable but do not think it necessary to discuss the difference in provisions here.

$150,000 as earned by the stocks being transferred. It is significant that nothing was to be paid except from income as received.

There is thus no merit to the contention that the amount here was a return of capital in any form. The money was income paid to the decedent at his own direction and under an arrangement made by him at a time when he was the sole owner of the stock and when he could reserve part or all of the income therefrom if he desired. Under established principles of tax law, the income thus reserved was clearly taxable to the decedent. *Bettendorf* v. *Commissioner,* 49 F. 2d 173 (C. C. A. 8th); *Morton* v. *Commissioner,* 23 B. T. A. 930, affirmed *per curiam,* 61 F. 2d 1036 (C. C. A. 2d). To the extent of the $150,000, it seems clear that the trusts were merely conduits set up by the decedent to collect such income for him and pay it over to him. Cf. *Griffiths* v. *Commissioner,* 308 U. S. 355, and *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609. But as the court below held, it is immaterial for tax purposes whether the transactions are regarded as gifts of all the corpus and all income in excess of $150,000 or whether they are deemed to be gifts in trust with reservation to the donor of a specified portion of trust income as beneficiary. Cf. *White* v. *Rose,* 73 F. 2d 236 (C. C. A. 5th).

2. There is no conflict in the decisions as alleged by petitioner. *Helvering* v. *Falk,* 291 U. S. 183, involved a wholly different question. In *Curran* v. *Commissioner*, 49 F. 2d 129 (C. C. A. 8th),[2] on which petitioner relies, the taxpayer transferred a building to a corporation in which he was a large stockholder and received what was called a dividend although it lacked several distinguishing features of a dividend. It was held there that the building had been sold, not given, to the corporation, that the money constituted repayment for the building, and, since the sum received was less than cost, that the entire sum was a return of capital and not taxable. But in the instant case, the evidence did not establish that a sale had been made or that the sum received represented a return of capital.[3]

Robert Hoe Estate Co. v. *Commissioner,* 85 F. 2d 4 (C. C. A. 2d), is also distinguishable. In that case, the devisees of realty under a will, which failed to provide for the widow's dower, formed a corporation to own and manage the realty and made an agreement with the widow under which she released all her interest in the realty and its usufruct, and the corporation promised to pay,

[2] The *Curran* case was decided 14 days before the same court decided *Bettendorf* v. *Commissioner*, *supra*, on which we rely, but the former was not discussed in the latter opinion and was evidently not considered as applicable therein.

[3] There was also no proof of the cost of the stock (R. 46).

not profits in kind but a sum equal to one-third of the company's net profits from the realty. The court held there that the sum paid to the widow could not be excluded from the taxable income of the corporation, and when paid to the widow represented the cost of acquiring her interest in the property. In this case the decedent did not sell his stock. He merely created a trust reserving the right to receive $150,000 of the income from the stock.

CONCLUSION

This case presents no question which requires a review by this Court. The petition should be denied.

Respectfully submitted.

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